No. 14,960

IN THE

United States Court of Appeals

For the Ninth Circuit

WM. P. STUART, Collector of Internal Revenue for the District of Arizona, *Appellant,*

vs.

J. E. WILLIS AND KING-HOOVER CONSTRUCTION CO., *Appellees,*

On Appeal From the Judgment of the United States District Court for the District of Arizona

ANSWERING BRIEF FOR THE APPELLEES

FILED

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PAUL P. O'BRIEN, CLERK

ANDERSEN AND RAY AND
KENNETH C. CHATWIN
710 Heard Building
Phoenix, Arizona
Attorneys for Appellees

INDEX

CITATIONS

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JURISDICTION

The suit in the District Court was filed by plaintiffs December 17, 1952 (R. 3-6) seeking to recover $8,667.23 of their funds which the Collector had seized and applied in payment of liabilities not owing by said plaintiffs (R. 4-5.)

A claim for refund seeking the return of these same funds had been filed by plaintiffs on the 26th day of December, 1951, (R. 5, 17 and Ex. 3) and had been denied by the Collector by letter dated the 29th day of July, 1952. (R. 5,8).

The court below took jurisdiction under 28 U. S. C. 1340 which reads in part, "The District Courts shall have original jurisdiction of any civil action arising

under any act of Congress providing for internal revenue."

28 U. S. C. 1291 provides this court with jurisdiction on appeal.

STATEMENT OF THE CASE

The basic question here involved is whether the Collector should be permitted to seize funds earned by and due to a joint venture and apply a portion of such funds in payment of the separate tax liability of one of the joint venturers.

Appellant in his appeal is asking this court to upset a finding of fact by the District Court that such a joint venture existed and to find instead that Willis was a mere creditor rather than a partner.

Proceeding from the premise that these were not joint venture funds which were seized, appellant next asks this court to rule that the Assignment of Claims Act of 1940* prohibits Willis from obtaining any interest in the funds here in question superior to that asserted by himself.

Other assignments of error raised by appellant assert (a) lack of jurisdiction by the trial court due to an alleged variance between the claim for refund and the complaint, and (b) a question about the amount of interest on the judgment.

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*The assignment of claims Act of 1940, 26 U.S.C. 3797, is set out in Appellant's brief (pp. 33-34) and for the sake of brevity will not be duplicated herein.

Appellant's brief contains a statement of facts, which by his own admission is, " . . . . . . limited to pertinent facts with respect to which we feel there will be no dispute . . . . . ." Brief p. 3). Much of his brief is devoted to an attack on other specific findings of fact by the court below which he regards as still in dispute. We desire to have before this court a statement which recognizes these specific findings.

The fact situation is not complicated. On November 16, 1950, John E. and Edith P. Willis (hereinafter called Willis) and the King-Hoover Construction Company (hereinafter referred to as the Company) entered into a joint venture agreement (Ex. 1). The Company was in a preferred position to obtain a desirable construction contract with the government, but lacked the necessary funds. By this agreement Willis obligated himself to provide $50,000.00 in cash if the company would obtain the contract. It was agreed that the profits would be divided in a ratio of 75% to the Company and only 25% to Willis, but the Company and its officers pledged themselves to see that Willis did not suffer any losses and in any event Willis was to receive a minimum return of 8% per annum on his investment. In addition thereto, it was provided that the $50,000.00 invested by Willis would be returned to him from the proceeds of the government contract (Ex. 1).

Willis did not suffer any losses and in any event Willis was to receive a minimum return of 8% per annum on his investment. In addition thereto, it was provided that the $50,000.00 invested by Willis would be returned to him from the proceeds of the government contract (Ex. 1).

The company bid on and obtained the contract. Willis

advanced the $50,000.00 and later had to advance an additional $7,800.00 to keep the project going (R. 82).

On June 16, 1951, Willis, in order to further insure himself against loss of his investment, obtained from the company a formal assignment (Ex. 6) of all amounts due or to become due under the government contract.

While this contract was being completed, the company became indebted to the Collector for payroll taxes on other jobs which it was doing which were not in any way related to the joint venture contract. During the months of July, August and October, 1951, the Collector filed liens against the company for these unpaid taxes.

On November 6, 1951, the joint venture contract was satisfactorily completed and the venture became entitled to receive the final payment in the sum of $12,278.18. On this date the collector seized the funds and applied them as follows:

In payment of payroll taxes owed by the joint venture	$ 3610.95
In payment of payroll taxes owed by The King-Hoover Construction Company	8667.23
Total	$ 12278.18

The joint venture filed a claim for a refund of the $8667.23 which the Collector had applied in payment of King-Hoover's separate liability, and by means of some 8 supporting schedules (Ex. 3) set forth in detail the facts surrounding their claim. The claim was denied by the collector by letter on July 29, 1952, and this suit was filed in the District Court on December 17, 1952, by the joint venturers.

The complaint prayed for return of the $8667.23 together with interest at the rate of 6% per annum from November 6, 1951.

The trial court gave judgment for plaintiffs in accordance with the prayer of their complaint and the collector brought this appeal.

SUMMARY OF THE ARGUMENT

Appellant's assertion of lack of jurisdiction ignores the fact that both the claim for refund and the complaint set forth in detail all basic facts which were necessary for a determination of the case and both ask for identical relief. It appears that appellant refuses to recognize the existence of the joint venture and their right to assert claim to property improperly seized. Appellant raised this question for the first time after the trial in the lower court and therefore the trial court could not inquire into the matter.

The second assignment charges the court below with error in finding a joint venture existed. This, we believe, flies directly in the face of overwhelming evidence. Both the document creating the relationship, and the activities of the members of the venture in jointly carrying the government contract to completion, show a joint undertaking and a community of interest in the profits. The proceeds from the contract were the joint venture funds which the Collector seized and applied in payment of the separate liability of one of the partners. The trial court held this to be error and decreed that they should be returned. The trial court specified, on the evidence presented, which member of the venture was entitled to receive the funds, i.e. J. E. Willis. This was within the scope of the

court's inquiry since the complaint prayed for such relief.

The third and fourth assignments of error discuss the relative lien rights of the Collector and Willis, assuming that no joint venture existed.

We assume that even in the absence of a joint venture, Willis had a superior lien. The undisputed evidence shows that his lien was prior in time. The Assignment of Claims Act of 1940 was enacted to protect the government from multiple claims just as appellant alleges. However, this Act should not be construed to give the Collector additional lien rights. The problems which this legislation was enacted to solve are not present here. No one made any assignment to the Collector and the only other parties here involved are joined as plaintiffs.

Not only this, but the Collector is asserting a lien on $5489.59 of the funds here involved in payment of a debt which did not even exist at the time the funds were seized.

The problem relating to interest will be discussed later.

ARGUMENT

I.

There was no evidence submitted to the trial court calculated to either prove or disprove appellant's challenge of jurisdiction.

Whether a fatal variance exists between the claim for refund and the complaint would ~~not~~ appear to depend

upon whether the claim and the complaint both lead to an investigation of the same fact situation and both request the same type of relief based upon those facts.

Appellant has cited some ten cases as authority supporting his contention of variance (Br. P. 12). The decision in one of these cases, *Bemis Bros. Bag Co. v. United States,* 289 U. S. 28 was against the Collector. In still another of the cases cited, the court reviewed its prior decisions (a number of which are cited by appellant) and then made the following obeservation:

> "Where a claim which the Commissioner could have rejected as too general, and as omitting to specify the matters needing investigation, has not misled him but has been the basis of an investigation which disclosed facts necessary to his action in making a refund, an amendment which makes more definite the matters already within his knowledge, or which in the course of his investigation, he would naturally have ascertained, is permissible. On the other hand, a claim which demands relief upon one asserted fact situation, and asks an investigation of the elements appropriate to the requested relief, cannot be amended to discard that basis and invoke action requiring examination of other matters not germaine to the first claim." *United States vs. Andrews,* 302 U. S. 517, 524.

It appears to us that appellant is asking this court to apply the rules regarding variance in such a manner as to require the complaint to employ exactly the same words and phraseology as that of the claim for refund. The cases appellant cites do not support his theory.

We point out that the claim for refund (Ex. 3) is rather detailed and has attached thereto 8 supporting schedules which set forth the relationship of the par-

ties, a summary of their financial dealings, the nature of the claim and the amount thereof. The first schedule makes reference to the "Amount held by the Levy," and thereby explains the reason for the "overpayment."

Exhibit 8 in evidence is a letter to the Collector written by the accountants for the joint venture and contains additional information requested by the Collector as the first sentence thereof indicates. The Collector was made fully aware of all facts bearing upon the claim for refund.

If there is any fact of importance, relative to the claim which was omitted, we fail to see it. The complaint sets forth exactly the same fact situation, describes the relationship of the parties and points out that Willis is the member of the joint venture to whom the funds being sued for belong. Both the claim and the complaint spell out that appellant seized funds belonging to the joint venture and $8667.23 thereof was applied in payment of obligations owed solely by King-Hoover. Both recognize the indebtedness of the joint venture for $3610.96 (a portion of the $12,278.18) as being properly applicable against payroll taxes to be paid by the joint venture. Appellant seems to forget this when he makes the statement that ". . . . . Willis asserts a prior claim, not as a taxpayer . . . . ." (Br. P. 14, 15).

We see no fact situation in any of the cases cited by appellant analagous to those here and we find in them no authority for denying jurisdiction to the trial court.

II.

In his second assignment of error, appellant has attacked a specific finding of fact of the trial court

that a joint venture existed and has asked this court to review the finding.

This court has stated its position with regard to the reviewability of fact finding by a trial court in the following words:

> "Where a case is tried by the court, a jury having been waived, its findings upon questions of fact are conclusive in the courts of review, it matters not how convincing the argument that upon the evidence, the findings should have been different." *Ocean Accident & Guaranty Corporation v. Rubin,* 73 F. (2d) 157, 163 (C.C.A. 9th) (Quoting from *Stanly vs. Supervisors,* 121 U. S. 547).

Appellant in his brief blandly states that this finding that a joint venture existed between the parties " ..... is clearly contra to the provisions of the agreement and finds no support in the record ....." Br. P. 16). Such a charge that the trial judge's findings were completely baseless is rather serious.

While we hesitate to impose upon this court by entering into a consideration of the rather voluminous evidence bearing upon this point, we deem it necessary to refute appellant's statement and refer this court to a few items in the record showing that the trial court had adequate reasons for reaching its conclusion.

Possibly the most compelling evidence that a joint venture existed between Willis and King-Hoover Construction Co. is Plaintiff's Exhibit I in evidence.

This is the agreement which formed the basis for the relationship. The document uses the term "Joint Venture" no less than six times in describing the arrangement between the parties. The term "Joint undertak-

ing" is used once and the single word "venture" is used twice. Clearly the parties understood from the beginning that they were engaged in a joint venture.

The principal terms of the agreement are referred to in our statement of facts. We discuss other terms herewith. The company and the two officers of the company all pledged their personal credit, for what it was worth, that Willis would get his capital returned intact plus a profit of 8% per annum minimum. An additional guarantee that Willis would not lose his investment appears in paragraph 14 which gives Willis a prior claim on the proceeds from the government to the extent of his $50,000.00 investment.

Willis was doing everything possible to protect his investment. He was sacrificing a possibility of making more money, in order to obtain security, since he stood to earn only 25% of the profits made. However, he was not free from risk or loss. Claude Hoover, one of the officers of the company, while testifying under cross examination was asked "Q. He (Willis) didn't stand to lose any money on the deal, according to the contract, did he. A. Yes, sir, he did. If the bonding company had to finish the job, he did." (R. 147).

Because of the security measures taken, appellant characterizes the arrangement as "a mere loan agreement" and cites the case of *Chapman vs. Dwyer*, 40 Fed. 468, in support of his statement.

That case discussed the tests to be applied in determining the existence of a joint venture and stated: ". . . . . there must be understanding, express or implied, that each shall share in the profits as such so that each has an equitable interest in the profits themselves." Id. p. 471. We refer the court to the remain-

der of the opinion on the same page which cites other cases for the proposition that the tests of a joint venture are a proprietary interest in the profits and a joint undertaking.

In further refutation of the statement that this was a "mere loan agreement" we refer to other terms of the agreement which provide that:

(a) The job was to be bonded and the profit was to be computed according to accepted accounting practies (P. 9).

(b) The joint venture agreement was to cover any extensions or additions to the contract (P. 11).

(c) Lowell Monsees, agent of Willis, was to have joint control over all funds used in connection with the project and was to countersign all checks (P. 12).

(d) The $50,000.00 contributed by Willis was to be used exclusively on the joint venture (P. 8).

All of the above terms point to a joint venture rather than a relationship of debtor and creditor.

A joint venture as defined by the Internal Revenue Code is a partnership ". . . . . through or by means of which any business, financial operation, or venture is carried on, and which is not within the meaning of this title, a trust, or estate, or corporation." I. R. C. (1939) Sec. 3797 (a) (2).

The definition of a partnership has been laid down by the Supreme Court and cited by the Tax Court as follows:

> "The requisites of a partnership are that the parties have joined together to carry on a trade or

adventure for their common benefit, each contributing property or services and having a community of interest in the profits."

Howard Coombs, 20 BT A 1021, 1024, quoting from *Meehan vs. Valentine,* 145 U. S. 611, 618.

The essential elements are: A joint undertaking, contribution of property or services, and a community interest in the profits. The evidence of the case shows all three to be present and completely justifies the trial court in its findng.

Since a joint venture existed, the proceeds from the contract levied on by the Collector were funds owned by the joint venture. It is elementary law that a creditor of a partner may not proceed against a partnership property but must proceed against the partnership interest of the partner. 68 C. J. S. 695, and cases there cited.

Does the fact that the Collector is involved here as a creditor of one of the partners take this case out of the general rule?

Appellant so contends in his brief, (p. 15) and cites the case of *United States vs. Winnett,* 165 F. (2) 149 (C. A. 9) in support of his position.

Our reading of that case does not bring us to the same conclusion. The facts of that case show that Winnett borrowed $60,000.00 from Summers on his personal note and then later endorsed certain notes for Summers' benefit on which the latter was primarily liable. A written agreement between the two provided that if Winnett ever had to pay any of the endorsed notes due to Summers' default, he would be able to off-

set such payments against his $60,000.00 note to Summers. Winnett was specifically relying on his right of off-set when the loan was made.

When the collector in seeking to collect taxes owed by Summers, tried to enforce against Winnett the $60,000.00 note which he owed Summers, this court granted Winnett his right of offset.

Those facts are distinctly different from the case at bar. Surely appellant will not contend that the government had offset in mind when the contract was let to King-Hoover Construction Co. The agreement about the proceeds of the contract was between Willis and King-Hoover and not between the government and King-Hoover. Before leaving this case, we quote from the decision as follows:

> "Under S. S. 3672 and 3710 (a) of the Internal Revenue Code, ... the rights of the Collector do not extend beyond those of the taxpayer whose right to property is sought to be levied upon." *United States vs. Winnett* 165 F (2d) 149, 151.

This principle is widely recognized and the law has been well established that the rights of the Collector rise—

> "No higher than those of the taxpayer whose right to property is sought to be levied on." *F. H. McGraw & Co. vs. Sherman Plastering Co., Inc., et al,* 60 Fed. Supp. 504, 512.

A famous authority in the field of taxation has stated that:

> "The property of one person may not, however, be subjected to distraint to enforce the tax liability of another person." (citing cases.)

Merten's Law of Federal Income Taxation (1942-9th ed.) Vol. 9 P. 137.

On page 138 of the same volume, Mr. Merten states that:

> "While a partnership checking account in a bank is not subject to distraint to satisfy a tax assessed against an individual partner, the government's tax lien does attach to the taxpayer's interest in the partnership itself . . . . "

Defendant violated this basic law since the joint venture funds of $8667.23 were seized and applied in payment of a tax liability of King-Hoover Construction Co. *Stuart v. Chinese Chamber of Commerce of Phoenix,* 168 Fed. 709.

In discussing whether or not a joint venture existed, appellant sees in the failure of this organization to file certain tax reports a grave defect.

Aside from the fact that such a failure would have no bearing upon this matter if a joint venture actually existed we make the following observation.

The same employees here involved worked for both the joint venture and the King-Hoover Construction Co. Had two different payroll reports been prepared, there would have been an overpayment of payroll taxes for all employees who earned more than $3,000.00 during a calendar year from these two sources. Under the arrangement made, when the total earnings of an employee from the two sources reached the maximum salary upon which the taxes were assessed, no further employment security taxes or F.I.C.A. taxes were assessed and paid.

The government was certainly not damaged by this sensible arrangement and it saved an immense amount of paper work for the government, the joint venture and the employees who would have had to file claims for refund.

III.

Appellant's third point upon which he relies states that the purported assignment by King-Hoover Construction Company to J. E. Willis was not valid under Section 3477 of the Revised Statutes.

We defer consideration of said Section 3477 for a moment and point out that the original joint venture agreement (Ex. 1, paragraph 14) contains this statement:

> "It is further agreed that the said $50,000 is to be returned to second parties from funds held back by the United States Government to be paid to King-Hoover Construction Company upon completion of said job."

Assuming, without admitting, that the proceeds of the contract were not funds owned by the joint venture, we submit that this provision would have at least created a lien similar to that which has been recognized by the courts in the so-called "surety" cases. In these cases a contractor, in securing a bond from a surety company assigns all or a portion of the contract proceeds to the surety to secure the latter against any loss arising out of the execution of the bond. Such a provision is held to give to the surety an equitable lien to such proceeds superior to the lien of the Collector of Internal Revenue. *Glenn v. American Surety Co., et al,* 160 Fed.

977 (C.A. 6, 1947). *United States Fidelity and Guaranty Co. v. Triborough Bridge Authority* (N.Y. 1947) 74 N.E. 2d 226. *In re Van Winkle* 94 Fed. Supp. 711, Cf. *National Surety Co. vs. County Board of Education of McDowell Co.* et al 15 F. (2) 993 (C.A. 4).

In determining to what property interest a collector's lien for taxes attaches, the court refers to the laws of the state wherein such a property right exists. *Metropolitan Life Ins. Co. vs. United States* 107 F. (2) 311 (C.A. 6).

The joint venture agreement here involved was entered into in the State of Arizona and the contract performed therein. Under the decisions of the Supreme Court of that state, Willis would have an effective lien on the proceeds from the contract since the parties so intended. *Allen v. Hammon Lumber Co.,* 34 P. 2d 397, 44 Ariz. 145, *Barnes v. Shattuck,* 114 P. 952, 13 Ariz. 338.

It might again be asked whether a right of offset existed which would subordinate the lienor's rights to those asserted by the Collector. The Court of Claims discussed this matter in the case of *Seaboard Surety Co. vs. United States,* 67 F. Supp. 969, and on page 971 the court says:

> "The right of the Government to preference or priority in payment of debts due it is purely statutory . . . . . . The United States possesses the general as well as the statutory right, R. S. 236, 31 USCA Sec. 71, to supply any sum due by it to the extinguishment, in whole or in part, of any debt due to the United States on any other account by a person to whom the United States is indebted, but this is only the exercise of the common right

> which belongs to every creditor to apply the unappropriated monies of his debtor, in his hands in the the extinguishment of the debts due to him. *Gratiot v. United States,* 16 Pet. 336, 10 L. Ed. 759. The right of offset does not give the Government a superior legal or equitable claim to the funds in its hands . . . . . ."

It is noted that in the case cited, the Collector was given priority; however a special statutory right arose there due to a "legal and known insolvency manifested by some notorious act of the debtor pursuant to law." Id. P. 971.

No similar reason exists for preferring the Collector in the present case.

Appellant has spent some time in his brief discussing the "Assignment of Claims Act of 1940." His conclusion is that the assignment of claims under government contract (Ex. 6) executed by King-Hoover Construction Company to the Willises is ineffectual due to the provisions of said statute.

He has cited *Martin vs. National Surety Co.,* 300 U.S. 588, 594 in support of his statement that "The statute was designed to protect the Government from conflicting claims and multiple liability." (Br. P. 22). We agree. But appellant is here trying to use the statute, not as a shield, but as a sword. He is trying to bring into existence a substantive right in himself to the funds here involved. The cases interpreting this act have limited its effect to the purposes it was enacted to accomplish. *Thompson vs. Commissioner of Internal Revenue,* 205 F. (2) 73 (C.A. 3), *Hobbs vs. McLean,* 117 U.S. 567.

Even in the case cited by appellant the court there refused to go along with the "advocates of literalism" and stated that "The purpose of the statute was not to dictate to the contractor what he should do with the money received on his contract after the contract had been performed." *Hobbs vs. McLean,* Supra. Id. P. 595.

The court goes on to make this observation:

> "An assignment ineffective at law may nonetheless amount to the creation of an equitable lien when the subject matter of the assignment has been reduced to possession and is in the hands of the assignor or of persons claiming under him with notice." Id. P. 597.

In the Martin case, a contractor assigned the proceeds from the government contract to his surety and then later gave a creditor his power of attorney to collect the same funds from the government. Under this power of attorney, the creditor actually collected the funds, but the Supreme Court forced the creditor to surrender them in favor of the surety and certain materialmen claiming under the surety.

Even ignoring the joint venture aspect in the case at bar, the Martin case should be good authority for allowing Willis to recover here.

We submit that the statute was never designed to add another weapon to the collector's arsenal and thereby give him additional and superior lien rights which the statutes dealing with lien rights have failed to provide.

We further submit that even though a joint venture had not been formed, Willis had superior lien rights

to those of the Collector's, not only by virtue of the assignment of claim dated June 16, 1951, (Ex. 6) but also by reason of the joint venture agreement itself (Ex. 1) wherein the proceeds from the contract were assigned to Willis.

The Collector's lien did not arise until July 13, 1951, and thereafter, as the following summary taken from the assessment lists (Ex. 11) shows:

Assmt. List Page No.	Taxes for Quarter Ending	Type of Taxes	Date lien Filed	Amount Applied in Payment	Date of Payment
547	3/31/51	Withholding & FICA	7/13/51	$ 1114.75	11/6/51
39010	6/30/51	"	8/28/51	2388.64	11/6/51
39010	9/31/51	"	10/19/51	3285.20	11/6/51
2	Yr. 1951	FUTA Col. ltr.	10/5/51	5489.59	11/6/51
			Total	$12278.18	

We point out from the above schedule that the Collector seized funds on November 6, 1951, and applied $5489.49 thereof in payment of a liability for Federal Unemployment taxes for the year 1951. These taxes were not due and payable until January, 1952, and so we find appellant here asserting a lien on, and attaching funds in payment of a liability not even in existence at the time.

IV.

In discussing his fourth assignment of error, appellant does not discuss lien rights but again raises a question of fact. He again refuses to accept those facts found by the trial court to exist, i.e., that Willis was entitled to $8667.23. (R. 17—Fact #5). He refers to testimony on pages 74 and 81 of the record and mis-

interprets it. Under cross-examination Mr. Willis tried to explain to the appellant's attorney that an additional $7800.00 had to be invested in the project by Willis to keep it going. The attorney refused to place in evidence the written account of the advances and repayments which was available (R. 84). We refer appellant to the record, pages 81 - 84 and to Exhibit 3, Sch. 6 for a clarification of the matter.

V.

Appellant's Fifth assignment of error states that the court below erred in its allowance of interest.

We do not object to an alteration of the judgment so that interest is awarded to the rate of 6% from the 6th day of November, 1951, "to a date preceding the date of the refund check by not more than 30 days." (Br. P. 27). We should assume that the Collector would read such a term into the judgment when making the check.

In the other point raised under this assignment, appellant still refuses to accept the finding of the court below that the $12,278.18 seized by the Collector belonged to the joint venture (R. 17, Fact #3) and that of this sum $8667.23 was applied in payment of obligations not owing by the venture (R. 17, Fact #3).

Appellant's insistence that the court did not rule " . . . . that taxes of the purported joint venture were overpaid" (Br. P. 28) seems to us to ignore the fact, that throughout this case, plaintiffs have admitted their liability for payroll taxes in the sum of $3610.95, and the court has clearly recognized this in its rulings.

We cannot agree that the rate of interest should be reduced to 4% merely because the Collector applied these funds in payment of the wrong liability. The Collector was well aware of the interest of Willis in these funds before they were seized. (R. 36, 37).

CONCLUSION

It is submitted that if appellant's viewpoint of this matter were accepted, no one would be safe in forming a partnership or joint venture for the purpose of performing services for the government. The risk would always threaten that the Collector could step in, despite all safeguards, and seize funds due the venture and apply them in payment of tax liability of either partner for bygone years.

We cannot believe that Congress intended such a result. Surely the Collector should not be permitted to step in at the last moment and seize not only the fruits of risk and labor but the very investment by which the funds arose.

Appellant's contention seems to be that the Assignment of Claims Act of 1940 should be interpreted so that there was absolutely nothing which Willis could hav done to protect himself from the Collector's long arm. We do not believe that anyone, even the Collector, should be given the power to divest an investor of his property rights in this manner.

Respectfully submitted,

ANDERSEN AND RAY and
KENNETH C. CHATWIN
710 Heard Bldg.
Phoenix, Arizona